Monterey County Office of Education

Leadership, Support, and Service to Prepare All Students for Success

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Finance and Business Services — Bulletin No. 12-010

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To: Superintendents and Chief Business Officials

From: Garry P. Bousum, Associate Superintendent, Finance and Business Services

Subject: Background and Advice on the 2011-12 First Interim Report

This memorandum provides guidance and technical information regarding the completion of your 2011-12 First Interim Report and the related Multi-year Projections (MYPs). This advice incorporates changes since the "Background and Advice on the 2011-12 Enacted State Budget" which was issued on July 20, 2011.

BACKGROUND

On June 30, 2011, Governor Brown signed the State Budget Act, SB 87, Chapter 33, Statutes of 2011, and the Education Trailer Bill, AB 114, Chapter 43, Statutes of 2011. As a reminder, the 2011-12 First Interim Report will continue to include MYP's. The main provision that affects the remainder of the 2011-12 fiscal year are the "trigger" language that was enacted under the Education Trailer Bill AB-114. The provisions of the "trigger" is detailed below.

"TRIGGER LANGUAGE"

- The AB 114 "trigger language" provisions reference Education Code 42127 which specifies requirements for a school district's adoption of the annual budget. The "trigger language" does not reference Education Codes 42130, 42131, 42132 and 42133 which specifies requirements for a school district's interim reports. Therefore, MCOE will expect the 2011-12 First Interim Report to include MYPs for 2012-13 and 2013-14.
- AB 114 enacted "trigger language" that automatically implements reductions to K-12 education if state revenue forecasts of $88.5 billion are not met. Following is a formula for calculating the reductions implemented by the "trigger language."
    - If revenues for the year are estimated to be less than $1 billion below the forecast ($87.5 billion), then no changes are required.
    - If revenues fall between $1 billion ($87.5 billion) and $2 billion ($86.5 billion) lower, then a series of additional cuts are triggered, including a $23 million

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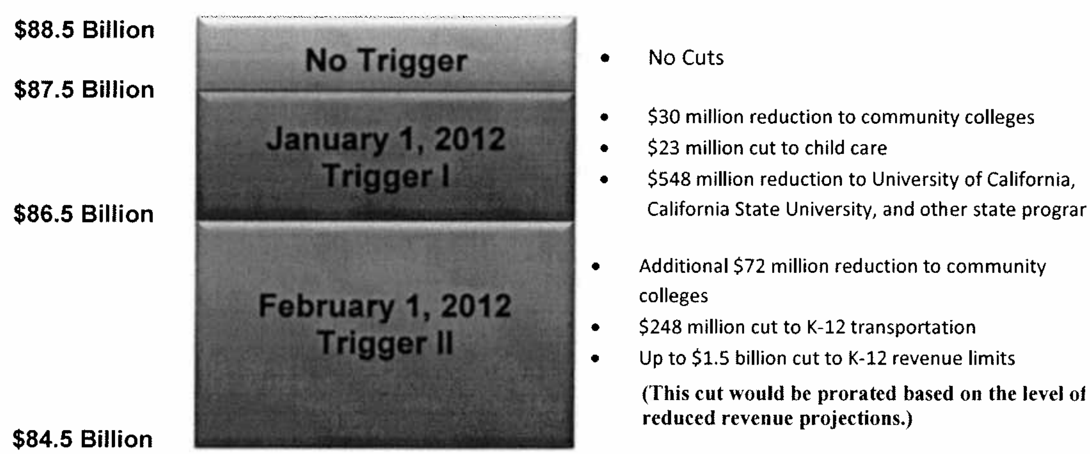
- across-the-board cut to child care and a $30 million reduction to community colleges, accompanied by a $10 increase to student enrollment fees (this is on top of the $10 increase included in the first Budget bill).
- If revenues fall more than $2 billion ($86.5 billion or less), then the state will impose additional cuts to public education of up to $1.9 billion: a 4% reduction to revenue limits; a $248 million cut to school transportation; and a $73 million reduction to community colleges.
- In addition, the revenue limit reductions would be proportional to the amount of the revenue shortfall. For example, if the shortfall is $3 billion, then the revenue limit reduction would be 2% rather than the 4% that would apply if revenues fall $4 billion or more below estimates.
- Below is the chart that illustrates the implementation of the "trigger language" provisions.

Summary of Potential "Trigger" Cuts if State Revenue Assumptions Are Not Met



Note: The Trigger II requires a drop of more than $2 billion which equals a 2.26% drop in state revenues from $88.5 billion to $86.5 billion.

Note: Chart and language courtesy of School Services of California.

- Contingent upon reductions authorized by the "trigger language" being implemented, AB 114 provides the authority for local school boards to negotiate the reduction of the school year by 7 days to a minimum of 168 instructional days.

There are many factors, both economic and others, which will affect the final outcome of the potential implementation of the "trigger language." Unfortunately, any changes to current law, should the trigger be pulled, will not be known prior to the school district's submittal of the 2011-12 First Interim Report, which is due to the

MCOE by December 15, 2011. Following are specific economic and other factors that could impact the implementation of the "trigger language."

ECONOMIC FACTORS

- Economic forecasts will be released by the Legislative Analyst Office (LAO) in mid-November and the Department of Finance (DOF) by December 15, 2011. The higher of the two agencies' forecasts will be used to determine if the "trigger language" is to be implemented. Absent further enactments that change existing statutes, and if the specified conditions for the "trigger language" provisions are met, the reductions will occur without any further action by the Legislature or the Governor.
- Economists with the UCLA Anderson Forecast released their quarterly forecast on September 20, 2011. This forecast indicates that both the national and state economies have stalled. This forecast is more pessimistic than the previous forecast.
- The Department of Finance reports that the year-to-date (July-September 2011) state revenues are down 3.4% for a loss of $654 million from the expected $19.39 billion. This is the fourth straight month that state revenues fell short of budgeted levels.
- The State's unemployment figures for August 2011 rose to 12.1%, which reflects an increase in the rate for the third straight month. This compares to the national unemployment rate of 9.1%.

OTHER FACTORS

- The "trigger language" applies to 2011-12. There continues to be a structural deficit that the State needs to address for 2012-13.
- While the Governor has expressed a clear intention to implement the "trigger language" if the required criteria are met, the Democrats have concerns about the implementation of the "trigger language."
- A Field Poll released September 19, 2011, reflects disapproval of the "trigger language" by the public.
- Education organizations continue to lobby the Legislature and Governor to not implement the "trigger language." School districts do not have the necessary tools to implement mid-year cuts due to actions taken by the Legislature and Governor.

Monterey County Office of Education Guidance

Based on the uncertainty over the implementation of the AB-114 "trigger" we offer the following guidance:

- MCOE expects that school districts will maintain "best fiscal practices." Moreover, our advice to school districts is that each district should continue with prudent fiscal management as provided through continuing AB 1200 statutes.
- MYPs are required for the 2011-12 First Interim Report.

- School districts should "plan for the worst case scenario and hope for the best". Financial projections should consider contingency plans for the possible implementation of the "trigger language."
- School districts should begin or continue negotiations in order to develop contingency language in the event that the imposition of mid-year cuts necessitates reducing the instructional year.
- School districts should consider waiting to restore any expenditure cuts until after a final decision on mid-year reductions and the Governor's 2012-13 Proposed Budget.
- School districts must carefully review their MYPs for one-time revenues and note the ending date of the revenues to avoid over projecting those revenues.
- Cash flow becomes a critical consideration. School districts may find it more difficult to issue TRANs and the cost of any borrowing will likely increase.

THE FOLLOWING SECTIONS PROVIDE MORE DETAILED ADVICE RELATIVE TO CHANGES SINCE THE ENACTED STATE BUDGET MEMORANDUM DATED JULY 20, 2011:

Revenue Limit and COLAs

AB 114 added Education Code Section 42127(a)(1)(A) which includes a requirement that "each school district shall project the same level of revenue per unit of average daily attendance as it received in the 2010-11 fiscal year." This applied only to the 2011-12 annual adopted and 45 day revision budgets and not to the 2011-12 interim reports. We recommend that school districts use the School Services of California (SSC) Dartboard, which was updated September 12, 2011, based on the 2011-12 Post AB 114 Prohibitions in the development of their 2011-12 First Interim Report and the related MYPs for 2012-13 and 2013-14. Please note the information relative to the "trigger language." Also note footnote 1 which relates to the statutory COLA, which reads, "While a positive statutory COLA is projected for 2012-13, the State's ability to fund it is suspect. Districts should have a contingency plan if the state decides not to fund the COLA."

Special Education Maintenance of Effort

The Special Education Maintenance of Effort (SEMOE) reports are required to determine if a special education local plan area (SELPA) or a school district met the maintenance of effort (MOE) required by the federal Individuals with Disabilities Education Act (IDEA).

First Interim provides an opportunity for school districts to determine compliance with this requirement. The SACS software includes the ability to test for MOE during the fiscal year on projected expenditures versus 2010-11 actuals. There are two planning opportunities; verify MOE for the upcoming year end for 2011-12 actuals versus 2010-11 actuals, and a required update if the most recent MOE compliance was not met for the 2011-12 budget versus 2010-11 actuals. For example, an adjustment could be made in the 2011-12 budget to ensure compliance. Non-compliance with MOE is an impact on federal funding through a reduction of funds. This check and update affords a chance to remedy the situation to reduce the risk of a loss in funding.

Child and Adult Care Food Programs

The California Department of Education Nutrition Services Division issued Management Bulletin NCD-CACFP-04-2011, dated June 2011 relative to contracting out for management functions in the Child and Adult Care Food Program. The Management Bulletin reminds all institutions participating in the Child and Adult Care Food Program (CACFP) that institutions may not contract with another company for all management functions. This includes a school district contracting with another school district or the county office for these functions.

Transportation

The Statutes are not clear relative to any formula to be used for the "trigger language" cuts to transportation, both regular education and special education transportation. A formula will be determined by the Department of Finance should the "trigger language" be implemented. As a way of estimating the impact, a school district could calculate the potential cuts by the following formula:

- 2011-12 transportation apportionment times 50% divided by 2011-12 estimated P-2 ADA equals potential loss per ADA.

Also note that a school district must expend 100% of the 2011-12 transportation entitlement (amount before the cut was applied) on transportation during 2011-12 in order to receive the same amount of funding for future years. The CDE is aware of this provision and is reviewing the possibility of a waiver should there be reductions due to the "trigger language" implementation.

Basic Aid School Districts

For 2011-12 and 2012-13, the State Budget provides for a reduction to state categorical funds provided to a basic aid school district in an amount equal to 8.92% of its revenue limit, commonly known as the "fair share" cut. A school district receives a fair share cut based on the district's basic aid status at the Second Principal Apportionment in the prior year. This means that for a school district to be subject to the 8.92% cut in 2011-12, it must be a basic aid district in 2010-11. If a school district becomes basic aid in 2011-12, it will be "subject" to the fair share cut in 2012-13. However, in no event would that reduction be more than the amount of local revenues that exceed the district's revenue limit.

Additionally, basic aid school districts should also be prepared to take their share of any "trigger language" reductions and should develop contingency plans accordingly.

Forest Reserve Funds

U.S. Senate Majority Leader Harry Reid has announced a bipartisan agreement to reauthorize the Secure Rural Schools and Payments in Lieu of Taxes program (Forest Reserve Funds) for five more years. Reauthorization of this program will bring some extra federal dollars to several school districts in the county.

Cash Related to RDAs

Assembly Bill 26 of the 2011–12 First Extraordinary Session (ABX1 26) eliminated redevelopment agencies (RDAs). The budget assumes that payments to schools will total $1.7 billion in 2011–12 reflecting an offset to the General fund and comes to school districts as property tax payments. The shift in the funds from Proposition 98 (Prop 98) through this re-benching mechanism reduces the availability of the cash to flow through as apportionments to school districts. The current apportionment schedule incorporates the loss of the $1.7 billion in Prop 98 funds. This shift in the funds should be taken into consideration for cash flow projections. Please note that there is pending litigation in the courts on this issue.

CASH MANAGEMENT

Intra-Year Principal Apportionment Deferrals

2011-12

SB 82 was chaptered on March 24, 2011 and allows for intra-year deferrals in the 2011-12 fiscal year. The intra-year deferrals from SB 82 are as follows:

Timeframe	Deferral Amount
July 2011 to September 2011	$700 million
July 2011 to January 2012	$700 million ($541 million was actually deferred)
August 2011 to January 2012	$1.4 billion ($1.2 billion was actually deferred)
October 2011 to January 2012	$2.4 billion ($2.2 billion from Principal Apportionment and the difference is a 100% deferral of the October consolidated categoricals payment plus a 7% deferral of the October Instructional Materials Realignment Program (IMFRP) payment)
March 2012 to April 2012	$1.4 billion ($837 million from Principal Apportionment and the difference will come from a 100% deferral of the March consolidated categoricals payment plus a 100% deferral of the March Economic Impact Aid (EIA) payment)

Inter-Year Principal Apportionment Deferrals

Please refer to the table below for a list of principal apportionment inter-year deferrals. The percentage of principal apportionment funds deferred across fiscal years in 2011-12 is 39%. **See Attachment A for a graphic illustration of all principal apportionment deferrals both intra-year and inter-year.**

2011-12	
Deferral Amount	**Timeframe**
$2.0 billion	February 2012 to July 2012
$1.3 billion	March 2012 to August 2012
$763.8 million	April 2012 to August 2012
$419 million	April 2012 to July 2012
$678.6 million	April 2012 to August 2012
$800 million	May 2012 to July 2012
$1.0 billion	May 2012 to August 2012
$2.5 billion	June 2012 to July 2012
$9.4 billion	**Deferred across fiscal years**

Also note that changes in property valuations can significantly affect cash flow. Also, the change in status from a Revenue Limit school district to a Basic Aid school district will impact the receipt of cash from monthly to primarily December and April.

Other Inter-Year Payment Deferrals

In addition to the inter-year principal apportionment payment deferrals, there are three inter-year deferrals applicable to K-3 Class Size Reduction, School Safety Violence Prevention, and Targeted Instructional Improvement Grant. The deferral amounts are listed below:

- $550 million for K-3 Class Size Reduction (CSR)
- $38.7 million for School Safety Violence Prevention
- $100.1 million for the Targeted Instructional Improvement Grant

Apportionment Schedules

In addition to apportionment deferrals, the State of California modified the principal apportionment payment schedules in 2009-10 to enhance the State's cash position in future years. In light of the reduced and deferred apportionments and change in timing of distribution of funds from the State, a great deal of emphasis must be placed on cash flow analysis and monitoring.

Please note that the principal apportionment deferrals will impact each school district differently depending upon: (1) the amount of State Aid revenue limit funding that each district receives and (2) the principal apportionment schedule that is dictated by Education Code Section 14041. There are three separate principal apportionment schedules outlined in Education Code Section 14041(a). Most school districts in California receive apportionments that are in accordance with Education Code Section 14041(a)(1)(2)(3)(4). However, there are a small number of districts in California that receive apportionments in accordance with Education Code Section 14041(a)(7) or Education Code Section 14041(a)(8). The Education Code Section 14041(a)(7) principal apportionment schedule applies to school districts that reported less than 5,000 units of average daily attendance in the 1979-80 fiscal year and that received 39 percent or more, but less than 75 percent, of their total revenue limits from local property taxes in that fiscal year. The Education Code Section 14041(a)(8) principal apportionment schedule applies to school districts which reported less than 5,000 units of average daily attendance in the 1979-80 fiscal year and which received 75 percent or more of their total revenue limits from local property taxes in that fiscal year. If your district does not meet the criteria for 14041(a)(7) or 14041(a)(8), then you receive principal apportionments according to the 14041(a)(1)(2)(3)(4) schedule. **Please see Attachments B-1, B-2, and B-3 for the three separate principal apportionment schedules that include monthly percentages for 2011-12.**

MCOE has always stressed the importance of maintaining appropriate reserves. **These cash management challenges make it even more imperative that we consider reserve levels greater than the minimums required within the State's Criteria and Standards.** Reserves are especially critical in order to meet cash flow needs that guarantee the ability to adequately meet payrolls and other obligations.

RESERVE FOR ECONOMIC UNCERTAINTIES

The revised 2009-10 Enacted Budget lowered the minimum reserve requirement levels for economic uncertainties to 1/3 the percentage level adopted by the State Board as of May 1, 2009. SB 70 extended this provision for both 2010-11 and 2011-12. However, school districts are required to make progress in the 2012-13 fiscal year to return to compliance with the specified standards and criteria adopted by the State Board. By fiscal year 2013-14, school districts must meet compliance and restore the reserves to the percentage adopted by the State Board as of May 1, 2009. We believe that the percentages established in the Criteria and Standards for reserves prior to the current Enacted Budget are the BARE MINIMUM. Moreover, once the minimum reserve levels are reduced, it would take budget reductions of twice the amount of the lowered reserve levels to fully restore the reserve by June 30, 2014. With the continued deferral of apportionments, it is more critical than ever to maintain higher levels of reserves for cash flow purposes. Remember that a school district needs a state loan when they run out of cash and do not have any other borrowing options even if the school district has a positive fund balance.

Basic aid school districts are advised to maintain reserves much greater than the State required minimum because they do not have the prior year ADA protection provided to school districts under Education Code 42238.5, whereby revenue limit funding is based on ADA for either the current or prior fiscal year, whichever is greater.

NEGOTIATIONS

When considering a multi-year contract, school districts need to be very flexible and have appropriate contingency language, such as basing compensation increases on "funded COLA" or "effective COLA." Also recognize that there may be different COLAs and deficits for revenue limits versus categorical programs and this should be considered during negotiations.

It is also important to note that the 2011-12 Enacted State Budget provides flat funding, but AB 114 incorporated "trigger language" reducing revenue limit apportionments if state revenues do not reach a specified level. School districts need to consider this as they negotiate changes to collective bargaining agreements.

SUMMARY

We recognize that these are extraordinary economic times and it is difficult to gauge the future. School district budgets should be managed with an eye to the significant downside risk created by the State's ongoing structural deficit. In these times of great economic and budgetary uncertainty, school districts need reserves that are much greater than the minimum.

We recommended that school districts continue to be cautious and focus on a multi-year strategy when recommending decisions and obtaining agreements. Attention should be focused on the multi-year projections for 2012-13 and beyond. School districts should "plan for the worst, but hope for the best," and develop financial projections accordingly.

MCOE recommends that each district monitor cash flow projections, review the State Board of Education Adopted Criteria and Standards, and keep in mind the FCMAT Predictors of Schools Needing Intervention (Attachment C). These are very useful tools in the review of the school district budget and interim reports.

We understand how difficult it is for school districts to deal with the increased pressures, significantly reduced funding, apportionment deferrals, and the uncertainty associated with a volatile economy. It is important that school districts be proactive through developing contingency plans that allow the most flexibility possible.